DEC 15 1983

TO: CCMA

FROM: Clarence J. Brown

SUBJECT: Working Group On Consultant Services

Following are four recommendations which I intend to present to OMB. I have also included the rationale supporting each recommendation.

RECOMMENDATIONS TO BE MADE TO OMB

1. Direct all agencies to identify actual expenditures during FY 1983, for items designated by Team 1 as requiring special control or scrutiny.

2. Direct all agencies to identify FY 1985 budget estimates for the categories included under the Team 1 definition.

3. Direct all agencies to designate a high-level political appointee, independent of program activities, to be responsible for validating the need for requests. The responsibility can be placed at the level of an Executive Assistant to the Secretary or Deputy Secretary, or the Assistant Secretary for Administration .

4. Ensure that existing Governmentwide reporting requirements for actions in excess of $10,000 are not relaxed as a result of the recent increase to the small purchase threshold from $10,000 to $25,000 (Public Law 98-191).

RATIONALE FOR RECOMMENDATIONS

Accomplishment of the first recommendation should enable top Government officials to understand the magnitude of expenditures in the areas which we feel warrant special controls. This, in turn, should result in strong agency support for necessary control systems.

The similar identification requirement for FY 1985 estimates should further emphasize the volume of dollars which is being expended and may indicate a trend of spending in these areas.

Discussions within the Task Teams have clearly demonstrated that control systems will work only if support and involvement from top agency officials occur. Therefore, the institutionalizing of an Agency position for validation or rejection of questionable requirements appears necessary.

Existing Governmentwide reporting requirements (Federal Procurement Data System - FPDS) do not capture expenditures for items requiring special controls if individual actions are $10,000 or less (small purchases). With the recent change to the small purchase threshold, we are concerned that substantial reportable data for special control items will be lost if the FPDS reporting requirements for small purchases are expanded to $25,000. The lack of adequate reporting may provide an opportunity to avoid necessary controls.

CONTRACT FINANCING

OMB CIRCULAR A-125

This paper summarizes Administration efforts to integrate good cash management and sound procurement principles, and seeks a decision on how best to proceed with revisions to contract financing policy.

Background

Most Government contracts are financed on a current basis; i.e., the contractor receives Federal cash at, or near, the point that it incurs costs, rather than being paid on delivery. The rationale for this type of financing is that private firms cannot afford the investment in work-in-process that would be required to manufacture airplanes, ships, weapon systems, buildings, etc. At the present time, an estimated $100 billion a year is provided to contractors as progress payments, interim payments, or advance payments.

OMB Circular A-125, "Prompt Payment," was issued last year to implement the Prompt Payment Act (P.L. 97-177). The Circular requires that Government bills be paid on time, but no earlier than called for by the contract. After initial disagreement between OMB and DOD regarding applicability, these rules were applied to payments that are made after delivery of goods or services, while further study of progress payment policy took place. In the meantime, the Grace Commission and the Senate Governmental Affairs Committee recommended reducing the rate of progress payments. They argued that high progress payments shift part of the cost of Government contracting to Treasury in the form of interest costs on funds advanced to contractors. At present levels, this interest cost would be about $9 billion a year.

OMB Proposal

On September 8, 1983, OMB attempted to address the contract financing issue by proposing a change in policy that would make progress payments optional; i.e., contractors would be able to propose alternative financing arrangements and those arrangements would be considered in deciding which contractor to do business with. For example, if two firms offered the same price, but one wanted financing and the other did not, you would choose the one that did not, thereby saving the interest cost that would have resulted from with earlier payment to the other. In more complicated cases, the two firms might offer differing prices, so calculations would have to be made to see which would be the lower overall cost to the Government.

Discussion

The OMB proposal was developed as part of our cash management initiative under Reform '88, and is supported by Treasury as a way of introducing good cash management to the procurement process.

The proposal has drawn fire from industry on the basis that high progress payments have become part of doing business with the Federal Government, and that any change would be disruptive to the competitive balance. They argue that the proposed policy may be appropriate for relatively small procurements, but that no contractor should be expected to finance the production of major weapons systems or other big ticket items. They also argue that any reduction in progress payments would result in the long run in higher prices to the Government that would more than offset the short term interest and outlay savings.

DOD pointed out that the original proposal would have imposed a great deal of paperwork on industry, in that it asked for duplicate bids or proposals--with financing and without it. Industry spokesmen made the same point, as did a number of Government procurement officials. OMB agrees with these comments, and any final policy will eliminate the requirement for duplicate bids or proposals.

Others objected to the original proposal because it would have raised the threshold for receiving progress payments to contracts of over $10 million. They pointed out that this would hurt smaller firms that are the cornerstone of the defense industrial base. OMB agrees with these comments as well, and would propose to leave the threshold at its present level of $1 million.

Conclusion

On the basis of public comment and consultations with industry, OMB has revised its original proposal, and has developed an alternative proposal that would apply only to relatively small procurements. The two proposals are included as Attachment A and B respectively.

The first alternative corrects deficiencies in the original proposal, but retains the policy that contractors would be permitted to propose various financing arrangements and that those arrangements would be considered as one of the contract evaluation factors. There would be no mandatory requirement to propose financing arrangements, nor would there be any increased paperwork for industry. Government procurement officials would have to make calculations to determine the best overall price offered.

The second alternative is closer to current policy, providing for progress payments on all major contracts. The time value of money would be considered only when progress payments are provided for commercial-type items. This would include only relatively small procurements.

Alternative 1: Corrected version of original proposal, continuing progress payments, but permitting firms to propose alternative financing arrangements.

Pros

-- Follows through on the President's commitment to bring good cash management to Government.

-- Permits industry to offer alternative financing arrangements that may be to the mutual benefit of the Government and themselves.

-- If industry uses new discretion, could reduce outlays without reducing programs.

-- Responds, in part, to recommendations of the Grace Commission and Senate Governmental Affairs Committee.

Cons

-- Will be strongly opposed by major Government contractors and their associations.

-- Could disrupt the competitive balance among Government contractors.

-- Could result in higher long-term procurement costs that might offset short-term interest and outlay savings.

Alternative 2: Current policy, with cash management taken into account in purchase of commercial-type items.

Pros

-- Retains the status quo while calling for some consideration of cash management principles.

-- Acceptable to representatives of major Government contractors.

-- Might be seen as a partial response to recommendations of the Grace Commission and the Senate Governmental Affairs Committee.

Cons

-- Will have little impact on contract financing.

-- May be seen as a weak response to the President's call for better cash management.

Decision

Proceed with issuance of Alternative 1. ____________

Proceed with issuance of Alternative 2. ____________

Attachment A

CIRCULAR A-125

Alternative 1

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Payment Terms

1. This Attachment establishes standards for assuring that appropriate payment terms are included in all Government contracts. It supplements the guidance provided in paragraph 6, "Payment Standards," of the basic Circular.

2. Generally, payments for goods and services acquired by the Federal Government are made after receipt, inspection, and acceptance of the goods and services, or through reimbursements on cost type contracts.

3. In other cases, payment may be made before receipt of goods or services. These payments, or contract financing, are referred to as progress payments, advances, or prepayments.

a. Criteria for Contract Financing

(1) Contract financing normally will not be provided when the contract items are the same as, or similar to, items for which progress payments are not customary commercial practice.

(2) Agencies shall use partial payments in lieu of contract financing to recognize the completion of contract milestones and partial deliveries of required goods and services.

(3) Contract financing will be offered under the following circumstances:

(a) When the reliability of the contractor and the adequacy of the contractor's accounting systems have been established by the contracting officer, and

(b) When the contractor will not be able to bill for the first delivery of products or other performance milestones after work begins for a period of 4 months for small business concerns and 6 months for others, and

(c) When the value of the contract or group of contracts the contractor will perform exceeds $100,000 for small business concerns and $1,000,000 for others.

(4) Contractors shall be permitted to include in and as a part of their bids or proposals the financing arrangements preferred or offered by the contractor. This would

include, for example, the rate or amount of financing desired by the contractor and time periods for payment of contractor invoices. In analyzing such bids and proposals, the contracting officer will consider the time value of money to the Government for the various proposed financing arrangements and will consider this as one of the evaluation factors.

b. Consideration for Contract Financing

Agencies will require consideration for contract financing when:

-- Contract financing is added to a contract after award.

-- Progress payments are authorized at intervals more frequently than monthly.

-- Progress payments are authorized at rates higher than normally available under the agency's policy.

4. When the time value of money is an evaluation factor, agencies shall include in the price negotiation memorandum or contract file a statement of how the various bids and proposals

were compared. Time value of money calculations shall be based on the interest rate established pursuant to paragraph 4.b. of this Circular.

5. Contractors shall be required to remit contract debt in excess of $10,000 via electronic funds transfer in accordance with Treasury Department regulations.

6. The approval of a progress payment request shall be considered receipt of an invoice as defined in paragraph 4 of the basic Circular.

7. Guidelines and instructions for implementing the provisions of this Attachment will be set forth in applicable acquisition regulations within 90 days from date of its issuance.

Attachment B

CIRCULAR A-125

Alternative 2

TO THE HEADS OF EXECUTIVE DEPARTMENTS AND ESTABLISHMENTS

SUBJECT: Payment Terms

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(b) When the contractor will not be able to bill for the first delivery of products or other performance milestones after work begins for a period of 4 months for small business concerns and 6 months for others, and

(c) When the value of the contract or group of contracts the contractor will perform exceeds $100,000 for small business concerns and $1,000,000 for others.

(4) If a procuring activity determines that contract financing should be considered in a procurement of the type covered by Section 3.a.(1) above, the contracting officer shall certify to that effect, and such certification shall specify the reasons therefor and that the cost of such financing has been considered in making such determination.

b. Consideration for Contract Financing

Agencies will require consideration for contract financing when:

-- Contract financing is added to a contract after award.

-- Progress payments are authorized at intervals more frequently than monthly.

-- Progress payments are authorized at rates higher than normally available under the agency's policy.

4. Contractors shall be required to remit contract debts in excess of $10,000 via electronic funds transfer in accordance with Treasury Department regulations.

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